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HAWALA: THE TERRORIST'S INFORMAL FINANCIAL MECHANISM

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Since 9/11, investigations into the al-Qaeda financial network have led to several notable successes in the United States and Europe. Much of this achievement in the United States has resulted from strengthening the financial investigatory powers of domestic law-enforcement agencies and coordinating them through the Treasury Department's new Foreign Terrorist Asset Tracking Center. In other countries, the Paris-based Financial Action Task Force, for example, is helping to coordinate the tracking of terrorist funds through the global banking system and cracking down on countries that fail to improve transparency and regulation. These efforts are already proving useful in uncovering large-scale drug-trafficking and money-laundering operations. They have also helped reveal important information on terrorist groups, particularly those operating in the West.

Financial investigators tracking al-Qaeda assets rely heavily on data and paper trails from commercial banks and financial regulators in pursuing and investigating leads. Such data have involved the tracing of wire transfers between suspected hijacker Mohammed Atta and Shaykh Said of Dubai, believed to be one of Osama bin Laden's key financial operatives. Unfortunately, these efforts have achieved little success to date in reaching the core of the al-Qaeda financial network. The problem is that many of the organization's funding mechanisms – like its cells – are small and inconspicuous, often using a traditional Muslim method of money exchange called *hawala.*

WORKINGS OF THE SYSTEM

The word "hawala" means "transfer" in Arabic. In some contexts, the word "hawala" is used synonymously with "trust," usually to express the personal connection between participants and the informal nature of transactions that are not formally documented.

In essence, hawala is a transfer or remittance from one party to another, without use of a formal financial institution such as a bank or money exchange and is, in this sense, an "informal" transaction. There are several other common aspects to hawala. First, in most cases, hawala transactions go across international lines, such as with worker remittances to their home countries. Second, hawala usually involves more than one currency, although, again, this is not absolutely required. Third,

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a hawala transaction usually entails principals and intermediaries. To accommodate requests of the principals, the intermediaries usually take financial positions. Later, much as in the case of conventional banking practices, these transactions will be cleared among the units to balance their books.

A typical transaction often involves an expatriate remittance. For example, an expatriate Pakistani worker in the UAE wishes to send money back home. To do this he goes to an intermediary, the *hawaladar*, to arrange the transfer. He makes payment in dollars or other convertible currency. The hawaladar in the UAE contacts a counterpart in Pakistan, who makes payment in rupees to the remitter's family or other beneficiary. Obviously, some network of family or connections among hawaladars is required to make such a system work on a large-scale and ongoing basis.

It is important to note that, although the remitter in this case wished money to be sent to a distinct location, no money actually crossed the border physically and no money necessarily entered the conventional or official banking system (unless of course the Pakistani recipient decided to place it there). The transaction rests upon a single communication between hawaladars and is often not recorded or guaranteed by a written contract. The trust between the two hawaladars secures the debt and allows the debt to stand with no legal means of reclamation. There is an implicit guarantee on payments, however, because a broken trust would result in community ostracism constituting economic suicide for the hawaladar.[1]

Typically, poorer individuals use the hawala system to take advantage of its low cost and fast delivery. For the blue-collar worker who transfers a monthly stipend of $100, the unofficial hawala is a far cheaper way to send money back home than the official banking system, at a rate of around 1 percent of the amount transferred. Because of its low overhead costs, hawala provides a more favorable market exchange rate than the official one. In short, the economic attraction of hawala to the customer is usually the speed, low cost and reliability of the system compared to the use of established financial institutions: banks, money exchanges, Western Union, Money Gram and other providers of this service.

The system is ideal for use in isolated localities like the tribal areas of Pakistan and Afghanistan, where formal financial institutions are rare.

EXTENT OF THE SYSTEM

Hawala agents work in a range of settings, from curbside stalls and modest offices in South Asia to back rooms and secret locations in Europe and North America. The only limits to the size of a transaction are the willingness of the sender to carry cash and the capacity of the receiving agent to cover the transaction. Exchanges in the tens of thousands of dollars are frequent.

Although Pakistan, India and the Persian Gulf states are home to the largest concentration of hawala organizations, Dubai, in the United Arab Emirates, perhaps handles the largest volume of transactions. The system has global reach. Investigators believe hawala organizations exist throughout the United States and Europe.

Given its informal nature, there is no precise measure of the size of the system.

Estimates abound, however.[2] Pakistani officials estimate that more than $5 billion enters the country through hawala networks every year, making the system the country's largest source of hard currency. One third of that reportedly consists of the repatriation of funds from expatriate Pakistanis to their families. Pakistani nationals may hold between $40 billion and $60 billion in overseas financial assets, an amount roughly equivalent to the country's gross domestic product.

In the case of India, Interpol places the size of hawala at possibly 40 percent of the country's gross domestic product. In 1998 (the latest figures available) estimates place the amount of money in the country's system at $680 billion, roughly the size of Canada's entire economy.[3]

In summary, the hawala system, especially in South Asia, is extensive, extremely liquid and a rational choice for poorer segments of the population. While seeming a bit mysterious to outsiders, the hawala is comparable in mechanics and economic structure to most other remittance alternatives, including those that run through licensed channels. The most obvious "legal" problem with hawala in remitting countries is the lack of any registration or licensing, although the operations themselves are generally harmless. In receiving countries like India, there is in addition the more subtle potential clash between hawala operation and exchange controls. Hawala transactions often result in increased black-market transactions and expanded underground activity. The fact is, though, that hawala is essentially an economic phenomenon. It would remain so even if there were no terrorist international transfers, drug trade or money laundering.

Although the great bulk of hawala transactions are as harmless as the remittance example noted above, the system has proved to be extremely useful for money laundering and masking the intricate financial operations required by terrorists, drug dealers and other criminal elements. Given its size and semi-legitimate status in South Asia, it is not hard for terrorists to transfer money using the hawala channel. They are labyrinths replete with pseudonyms, middlemen and dead ends. Wealthy Arab patrons in the Middle East likely send funds to al-Qaeda through hawala organizations, as do myriad Arab charities acting as fund-raising fronts. The smaller the value of the transfer, the less attention it is likely to attract, but it is still easy to transfer large amounts of money without raising questions.

THWARTING TERRORISTS

In the war on terrorism, a major challenge will be to infiltrate and monitor hawala networks in the Middle East. A crackdown by Arab and South Asian governments at the behest of Western governments is simply not feasible. The vast majority of the money is from legal, legitimate sources, and the hawala organizations are numerous and extremely powerful.

Arab and South Asian governments have neither the effective means nor the will to closely monitor each transaction in these organizations. In any case, methods of this sort would most likely prove ineffective. As an amorphous collection of independent operators, hawalas do not depend on a single location or infrastructure. A crackdown would simply drive them underground. Because many citizens in these countries would view actions of this sort as caving in to Western demands at the expense of Muslim tradition, it could also create a backlash against the governments.

Instead, what may need to be done is to see how hawalas can be licensed and/or registered so that they will continue to serve those who need the service while, at the same time, not become abused by money launderers and criminals.

Along these lines, participants at a conference in Abu Dhabi held on May 16, 2002, recommended the setting up of control systems to monitor hawalas with sufficient documentation about the remitters and recipients, to guard against any diversion of funds into illegal or criminal activities. They also called for government licensing and regulation of hawala offices in the same way as insurance offices are regulated.

For its part, Pakistan is establishing a Special Investigation Group (SIG) in the Federal Investigation Agency (FIA) to counter terrorism. This group could help enforce hawala regulations. In addition, crime wings of the FIA would help the SIG investigate cash flows to and from suspected groups and individuals through illegal monetary transactions such as hawala.

If licensing, registration or normal police work[4] is ineffective in stopping the abuse of the hawala systems by terrorists, an economic approach should be considered. If the desire of the authorities is to constrain or significantly reduce the importance of hawala activity, this means reducing the economic incentives to do hawala. There is probably no better way to accomplish this than to facilitate cheap, fast remittances across international borders, and to do away with dual and parallel exchange markets, which are always an incentive to keep transactions underground.

If those countries had reasonably expedient, well-regulated and user-friendly banks, then the hawala system would not have flourished and would not have been abused by terrorists and criminal elements. In this regard, there have been some encouraging signs. Several exchange companies in Egypt, Jordan, Lebanon and the Gulf countries have now adopted the door-to-door delivery of money in a manner similar to one that the Philippine banks have successfully introduced and implemented to stave off the unofficial market operators. The more innovative institutions in India are now using low-cost couriers to deliver door-to-door service. This compensates for the lack of presence of banks in different parts of the country. The smaller and more numerous exchange companies are also competing today with the hawala system in speed, efficiency of execution, settlement and delivery of money and services.

These factors may bring down a hawala system that has been prone to errors, fraud and abuse by unscrupulous groups.

[1] Patrick Jost of the Department of the Treasury, "The Hawala Alternative Remittance System and Its Role in Money Laundering," Interpol, October 2, 2002, http://www.interpol.int/public/financialcrime/moneylaundering/hawala/default.asp.
[2] Ibid.
[3] Scott Baldauf, "The War on Terror's Money – India's Six Month Investigation Offers Lessons on Fighting Underground Banking," *Christian Science Monitor*, July 22, 2002.
[4] Holman Jenkins, "How About al-Qaeda's Moneymen?" *Wall Street Journal*, September 11, 2002, p. A15.